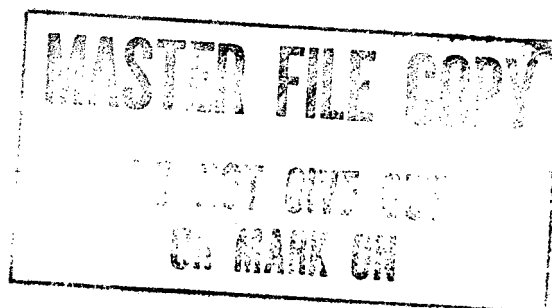




Directorate of  
Intelligence

~~Confidential~~



# Nicaragua: Economic Restructuring in the Communist Mold

25X1

An Intelligence Assessment

~~Confidential~~

ALA 83-10050  
April 1983

Copy--

344

**Page Denied**



**Directorate of  
Intelligence**

**Confidential**

# Nicaragua: Economic Restructuring in the Communist Mold

25X1

**An Intelligence Assessment**

This assessment was prepared by  of the  
Office of African and Latin American Analysis, with  
a contribution by  Office of Central  
Reference. Comments and queries are welcome and  
may be addressed to the Chief, Middle America-  
Caribbean Division, ALA,

25X1

25X1

25X1

This paper was coordinated with the Directorate of  
Operations and the National Intelligence Council,

25X1

**Confidential**  
*ALA 83-10050*  
*April 1983*

Confidential

**Nicaragua: Economic  
Restructuring in the  
Communist Mold** 

25X1

**Key Judgments**

*Information available  
as of 15 March 1983  
was used in this report.*

Relying heavily on foreign aid and government spending to keep it afloat, the Nicaraguan economy is drifting away from the Sandinistas' early goal of a speedy recovery to prerevolutionary levels of production. Soft growth in 1980-81—based in no small measure on additions to the public payroll—gave way to a downturn in 1982 that has left real output about 20 percent short of the peak 1977 level.

Nicaraguan Government policies have been largely responsible for the disappointing economic performance. Growing harassment of the private sector has precluded a resurgence in the business confidence that is the linchpin of sustained commercial and industrial growth. In addition, the regime's erratic—and often counterproductive—economic policies have encouraged subsistence farming at the expense of key export crops, a development that has aggravated a severe foreign exchange shortage.

The regime's earlier strategy of relying on public-sector expansion and generous foreign aid for small improvements in war-ravaged living standards backfired in 1982. We believe real output fell 5 to 10 percent last year largely because aid inflows from Mexico, the Middle East, and international financial institutions declined. The ensuing prospect of unmanageable fiscal deficits prevented the government sector from growing enough to compensate for weak private-sector performance.

Despite deepening shortages of basic consumer goods, rising unemployment, persistent inflation, and general dissatisfaction with the faltering economy, the Sandinistas kept their tight grip on power. The government retained widespread support among youth and the working class partly by blaming external forces—particularly US-sponsored, anti-Sandinista activity and economic aggression—for the economy's problems. The lower classes also continued to benefit from government spending for social services; despite budget cuts in 1982, outlays for health, education, and other services still exceeded prerevolutionary levels by a wide margin. At the same time, the regime moved quickly and effectively to quell sporadic opposition among labor and business leaders.

Confidential

ALA 83-10050  
April 1983

**Confidential**

Our research shows that certain changes central to the Marxist-Leninist approach to economic development are taking place in Nicaragua. These are manifest in the slow but cumulative strangulation of the private sector and the middle class. We believe this Marxist-Leninist economic course, now begun, would not be easy to reverse. Even if there were a change of government, the costs of rebuilding or re-creating a private sector would be great and the process time consuming.

In our view, the government's policies toward the private sector will constrain economic performance and inhibit any sustainable recovery through 1984. We analyzed the economic effects of three different scenarios for government policy. If, as we project, there is little change in the overall level of political tension, probable external factors—small fluctuations in foreign financing, world commodity prices, and weather conditions—will determine whether the economy crawls forward or slips back. By our calculations, Managua will require new foreign aid totaling about \$600-680 million in 1983 and roughly \$735-815 million in 1984 merely to shore up imports sufficiently to support the 3-percent annual economic growth needed to protect per capita incomes. Even then, economic growth will not be sustained unless conflicts between government and private business are smoothed over.

Beginning in 1985, when the grace period on rescheduled principal payments to foreign commercial banks starts to expire, the growing debt service burden could well tip the balance toward prolonged economic troubles. We believe there is a growing danger that the Sandinistas, legitimized by their almost certain victory in the planned 1985 elections, will cite the faltering economy as justification for further radical economic policies. These steps might include a unilateral repudiation of foreign debt, a nationalization of the remaining private sector, or both. Such actions would virtually guarantee a deep drop in living standards followed by a sustained period of economic stagnation, and Managua probably would seek greater amounts of Soviet financial aid.



25X1

**Confidential**

**Confidential****Contents**

	<i>Page</i>
Key Judgments	iii
Introduction	1
Postrevolutionary Performance, 1980-81	1
The Balloon Bursts in 1982	2
The Deteriorating Economy	2
Tightening Foreign Financial Bind	4
Domestic Impact and Reaction	6
The Next Few Years	6
Case I: Continued Sandinista Pressure on Business	8
Case II: Confiscation of the Private Sector	8
Case III: Change of Government	9
1985: A Pivotal Year	10
Implications for the United States	10
 <b>Appendixes</b>	
A.    Restructuring and Recovery, 1980-81	11
B.    Key Economic Players	15
C.    Methodological Notes on Economic Forecasts	21

**Confidential**

Confidential



633935 (545340) 3-83

25X1

Confidential

Confidential

## Nicaragua: Economic Restructuring in the Communist Mold

25X1

### Introduction

This paper updates a CIA assessment of the Nicaraguan economy published in early 1981.<sup>1</sup> In that first look at the postrevolutionary economy, we detailed Nicaragua's relatively good natural resource and managerial base and the uneven benefits accruing from rapid economic expansion under the Somozas. We described the heavy damage the revolutionary violence inflicted on the economy, including a 32-percent decline in real gross domestic product (GDP) during the period 1978-79, and tracked the factors behind the partial recovery in 1980. We concluded that sustained growth in this small, import-dependent economy would depend on whether the Sandinistas quickly restored business confidence and encouraged private-sector activities.

Since that time, mounting evidence from a wide variety of sources suggests strongly that the Sandinistas do not intend to accommodate the private sector significantly. Instead, the regime will continue to move toward its goal of building a Marxist-Leninist state within the constraints of international opinion and foreign financing.

In the light of these developments, this assessment reviews recent economic performance, examines Nicaragua's financial needs, and projects the likely course of development through 1985.

### Postrevolutionary Performance, 1980-81

Although the Sandinistas claimed to be building a mixed economy, our research shows that structural economic changes characteristic of the Marxist-Leninist development path began in 1980-81.<sup>2</sup> During

<sup>2</sup> For details of major structural economic changes begun in 1980-81 as well as economic performance for that period, see appendix A.

that time, the regime gradually but undeniably heightened pressure on the private sector and the middle class through intensifying antibusiness rhetoric, heavier taxes, and nationalizations. The government took on a greatly enlarged role in economic decision making, and the choices it made contributed greatly to the economic crisis that is now apparent.

According to official Nicaraguan information, at the end of 1981 economic output was still about 15 percent short of prerevolutionary levels despite the Sandinistas' initial target of achieving full recovery in 1980. Building from the war-ravaged base of 1979, measured economic growth totaled about 23 percent during the period 1980-81. This sort of expansion was unsustainable, however, because it was based on ballooning government expenditures to rebuild roads and utilities destroyed in the revolution, to improve education and health services, and to strengthen the armed forces. Paralleling—and amplifying—this expansion of public-sector activities, the government work force grew by at least 60 percent from prewar levels.<sup>3</sup>

To implement economic policy decisions, the regime used its control of credit and foreign exchange allocation. As it squeezed the private sector, the government share of the economy expanded and Managua directed an increasing portion of Nicaraguan investment. The regime's investment decisions favored agriculture—particularly basic grains for domestic consumption—and allowed industry to atrophy.

<sup>3</sup> Because the conventions of national income accounting provide that wages and salaries of government workers will be used to measure the output of the public sector, increases in the government payroll alone raise measured GDP

25X1  
25X1

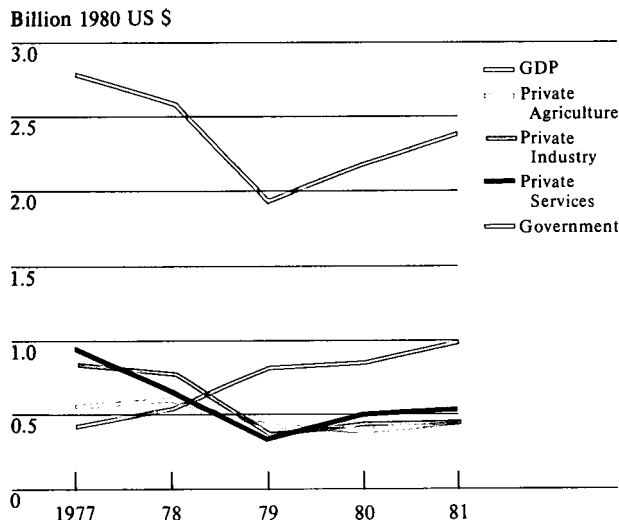
25X1

Confidential



Confidential

**Figure 1**  
**Nicaragua: Economic Performance by Sector**



589096 3-83

### The Balloon Bursts in 1982

Managua's formula for easy economic growth fell apart in 1982, and we estimate real GDP fell by 5 to 10 percent. Facing the prospect of an unmanageable budget deficit, the government sensibly canceled or deferred planned activities. This action, however, kept public outlays from expanding sufficiently to offset weak private-sector performance and the regime increased threats against the business community. Meanwhile, foreign financing slowed as Nicaragua's major lenders faced their own deepening financial difficulties. Compounding these problems, unusually severe weather depressed agricultural output. The resultant foreign exchange squeeze forced sharp cuts in import volume. Despite the drop in living standards and worsening shortages of consumer goods, the Sandinistas retained a firm grip on power, in part because they convinced the people that external forces were responsible for economic problems.

**The Deteriorating Economy.** Government spending quickly got out of hand when costs for summer flood and subsequent drought relief added to expenses associated with a state of national emergency declared in March. Declining overall production capped revenue gains from new taxes levied on personal and business incomes, and the projected 1982 fiscal deficit approached \$400 million. Rather than risk a sharp rise in the prevailing 30- to 35-percent rate of inflation that would have resulted from massive credit creation, Managua reined in spending.

The budget squeeze quickly made plain the Sandinistas' priorities. According to official information, military expenditures stayed roughly even with the inflation rate and were the only major budget item to escape large cuts. Other favored sectors did not fare as well. Health and education outlays declined at least 15 percent in real terms. The regime slashed budgeted capital spending, the economy's main source of investment.

Attempts to bail out the agricultural sector from the effects of bad weather failed to forestall a drop in farm production. Although we believe government claims of more than \$400 million in weather-inflicted damages alone were exaggerated, acute shortages of imported fertilizers, pesticides, and spare parts added to a poor growing season to yield meager crops. Managua claims basic grain output fell by 5 to 10 percent. Based on Nicaraguan Planning Ministry information, we calculate that export-crop performance was no better:

- Coffee output fell 6 percent as a result of labor shortages, poor maintenance, inadequate investment, and tight domestic credit. Increased export volume—diverted from stocks and domestic consumption—and stable prices led to a corresponding 5-percent increase in nominal hard currency revenues from this source, traditionally the largest export earner.

25X1

Confidential

Confidential

---

### *The Government Versus the Private Sector*

Since their takeover in July 1979, the Sandinistas have applied increasing pressure on the private sector. Immediately after coming to power, the regime expropriated the assets of former President Somoza and his associates, including the domestic banks and insurance companies, the mining and forestry sectors, and about 25 percent of the nation's arable land. As a result of these actions, the public sector accounted for about 40 percent of GDP in contrast to 15 percent before the revolution. Because Managua also assumed sole authority over allocation of credit, foreign exchange, and imports, however, the state exercised great control over the private sector. Nevertheless, most non-Somozista elements of the private sector supported the Sandinistas. [ ]

In 1980 nationalizations were few, but the regime showered the business community with threats and encouraged labor to report firms that were liquidating assets. Although the government hoped for a resurgence in private investment, Managua denied numerous requests for credit or foreign exchange, contending that the private sector had access to hoarded funds. Business confidence quickly waned, and the initially substantial middle class support for the revolutionary regime began to erode. [ ]

In 1981 the government increased harassment of the private sector:

- On the second anniversary of the revolution, the government nationalized 14 companies after charging them with decapitalization. The action shook the business community because the confiscations appeared arbitrary. The regime took over the thriving Prego soap company and the innovative La Perfecta dairy, among others.
- At the same time, stating that the owners had abandoned or were underutilizing land, the Sandinistas confiscated enough farmland to double state agricultural holdings. The regime also increased its authority over private agricultural cooperatives,

and reports appeared in the international press that government security forces were threatening members of the powerful Matagalpa coffeegrowers cooperative.

- In September, the regime declared a "state of economic emergency" and announced several measures that further discouraged entrepreneurial activity. These included prohibitions of unauthorized price increases and currency speculation as well as tighter restrictions on foreign exchange trading. The regime also instituted vague laws that would punish those caught disseminating false or misleading news about the economy.
- In October, four key private-sector leaders were jailed after they published a letter criticizing Sandinista economic policy.

Relations between the government and the private sector turned adversarial, but the business group's lack of effective leadership and fear of retaliation precluded any challenge to the regime's firm hold on power. [ ]

In March 1982 the Sandinistas declared a state of national emergency that is still in effect. Perceptions of an increasing US threat to the government prompted the regime to intensify efforts to expand the militia and strengthen government-run mass organizations, impose full censorship of the independent media, and issue new regulations greatly increasing potential government control over the economy. The announcement authorized the Ministry of Internal Commerce to direct production and sales throughout the economy and allowed it unlimited access to private firms' plants, offices, warehouses, and records. Although Managua has not taken full advantage of its authority, the decrees caused trepidation in the private sector because many business leaders believe the regulations may have set the stage for eventual government confiscation of the bulk of businesses still in private hands. [ ]

Confidential

**Confidential**

- Cotton production plummeted 17 percent because of flood losses, labor shortages, insect infestations, and an inadequate supply of imported fertilizers that are vital to the success of this crop, the second-largest export earner. Softening world market prices contributed to a 43-percent drop in nominal foreign exchange earnings.
- Sugar volume climbed 3 percent as investment was scaled down. The public-sector share of production grew from 40 percent in 1981 to 45 percent in 1982. Nevertheless, plummeting international prices slashed nominal export receipts by one-third.

Industry fared even worse than agriculture. In September 1982 the regime announced that investment in light, export-oriented industries—an important component of Nicaragua's economic development since World War II—had been a mistake. Without clear explanation to the public, the Sandinistas directed that investment priorities be shifted to agriculture. Long starved of foreign exchange and credit, local manufacturers were quickly devastated. According to a US Embassy source, nominal imports of raw materials and intermediate goods allocated to the industrial sector fell about 45 percent from depressed 1981 levels. Production sagged, particularly in the textile industry, and nominal export earnings from industry skidded 75 percent.

**Tightening Foreign Financial Bind.** The estimated foreign financial gap for 1982 shrunk to below \$460 million, but at the cost of a sharp reduction in imports. Weakening cotton and sugar receipts and decimated industrial sales abroad cut overall nominal export earnings by 20 percent to \$400 million. Even though Nicaragua continued to benefit from the grace period on restructured debt amortization, remaining principal and interest obligations and other services gobbled up about \$250 million. Lacking a foreign reserve cushion, Managua slashed import volume by about 30 percent, and foreign purchases fell below \$700 million for the first time since the war. As in 1981, consumers and industry bore the brunt of the import cutbacks.

**Table 1**  
**Nicaragua: Agriculture and**  
**Industrial Production by Volume**

Index: 1978 = 100

	1979	1980	1981	1982 <sup>a</sup>
<b>Total agriculture</b>	<b>86</b>	<b>79</b>	<b>90</b>	<b>80</b>
Export crops				
Cotton	20	67	70	58
Coffee	118	102	102	96
Sugar	71	60	64	66
Meat	93	70	54	50
Basic crops				
Corn	96	105	109	107
Rice	72	81	119	128
Beans	71	71	105	98
<b>Total industry</b>	<b>63</b>	<b>77</b>	<b>79</b>	<b>70</b>
Manufacturing	69	81	81	73
Construction	27	50	67	70
Mining	55	76	81	75

<sup>a</sup> Estimated.

Although Sandinista leaders toured the globe asking for aid, we estimate that foreign lending fell nearly 25 percent short of the 1981 total. Reeling from its own financial crisis, Mexico—the largest credit supplier—limited its loans to oil and other concessionary credits that reached little more than half the 1981 total. Also feeling the effects of soft oil markets, Arab OPEC countries cut lending. Meanwhile, multilateral support dipped as Nicaragua, fearful of stiff loan conditions, refused to seek help from the International Monetary Fund.

Official loans and government-backed supplier credits from Western Europe—particularly Sweden, Spain, and France—increased; however, these often were accompanied by stern warnings from governments that political pluralism must be obtained in Nicaragua if the financial spigot is to remain open. Support

25X1

**Confidential**

Confidential

**Table 2**  
**Nicaragua: Foreign Financing Gap**

Million US \$

	1980	1981	1982 <sup>a</sup>	1983 <sup>a b</sup>	1984 <sup>a b</sup>	
				Best Conditions <sup>c</sup>	Worst Conditions <sup>d</sup>	Best Conditions <sup>e</sup>
Current account	-425	-516	-361	-510	-550	-635
Trade balance	-435	-418	-298	-270	-310	-355
Exports, f.o.b.	450	501	400	500	420	500
Cotton	30	123	70	80	67	80
Coffee	159	137	144	186	168	186
Sugar	21	50	33	39	13	39
Meat	58	23	29	36	33	36
Other	182	168	124	159	139	159
Imports, f.o.b.	885	919	698	770	730	855
Net services and transfers <sup>f</sup>	10	-98	-63	-240	-240	-280
Amortization	75	66	98	90	90	100
<b>Financial gap</b>	<b>-500</b>	<b>-582</b>	<b>-459</b>	<b>-600</b>	<b>-640</b>	<b>-735</b>
Net direct investment	0	0	0			
Medium- and long-term loans	371	600	459			
Official	371	600	459			
Private	0	0	0			
Net short-term capital, including errors and omissions	-40	0	0			
Change in reserves	-169	18	0			

<sup>a</sup> Estimated.

<sup>b</sup> Data shown in these columns reflect limits of ranges developed in various economic growth and commodity price scenarios. For additional details on the scenarios and the methodology underlying our projections, see appendix C.

<sup>c</sup> Projected, assuming 3-percent economic growth and a moderate rise in world commodity prices.

<sup>d</sup> Projected, assuming no real growth and continuing low commodity prices.

<sup>e</sup> Projected, assuming 3-percent growth in 1983, 3-percent growth in 1984, and a moderate rise in commodity prices.

<sup>f</sup> Data for 1980-82 reflect large hard currency grants.

from South American nations—particularly Venezuela—also grew, virtually all in the form of official supplier credits. An Argentine diplomat told US Embassy officials that Buenos Aires issued a \$15 million credit in appreciation of Sandinista support during the Falklands crisis. Moscow claimed to have offered \$150 million in aid, but, based on US Embassy reporting, we believe that disbursements reached only about \$30 million worth of supplier credits for often unneeded or poor-quality merchandise. The Soviets

again failed to offer badly needed hard currency and continued to advise the Sandinistas to avoid antagonizing Western backers, according to US Embassy reports. In April Managua widely publicized a Cuban agreement to provide in 1982 supplier credits and technical assistance that both countries claimed was worth \$130 million.

Confidential

**Confidential**

**Table 3** *Million US \$*  
**Nicaragua: Estimated Official**  
**Foreign Loan Inflows <sup>a</sup>**

	1981	1982
<b>Total</b>	<b>600</b>	<b>459</b>
Mexico	250	145
Middle East	100	85
Multilateral institutions	130	69
Western Europe	32	68
South America	44	80
Other	44	12

<sup>a</sup> Hard currency loans and supplier credits.

Appeals to foreign bankers and investors met with little success since the conclusion of most debt re-scheduling in March 1982. Even a seemingly generous foreign investment law unveiled in December did not generate an encouraging response partly because of the regime's typically heavyhanded behavior toward the private sector. The Sandinistas twice in 1982 threatened to halt servicing Nicaragua's external debt unless the banks extended large new loans. Bankers refused to provide more than small short-term loans, but Managua continued to honor its debt obligations.

**Domestic Impact and Reaction.** Cutbacks in foreign and domestically produced goods hit consumers and industry hardest. Meat shortages developed and sugar rationing was instituted, according to the US Embassy and the Nicaraguan and international press, as Managua attempted to boost export volume at the expense of domestic consumption. We calculate that while meat production declined 7 percent, exports rose 26 percent and per capita consumption fell sharply. The government instituted gasoline rationing that cut fuel consumption 20 percent and later boosted prices 25 percent to compensate for lower sales tax revenues. Industry was stung by shortages of imported spare parts and inputs, particularly fuel, rubber, and glass. Farmers fared slightly better in getting much-needed

supplies, but an incentive program designed to raise foreign exchange payments to producers of export crops failed because the Central Bank lacked enough hard currency to support the plan.

Worsening economic troubles, including shortages of consumer goods, business failures, and the government's increasingly anti-private-sector posture, further sapped support from the middle and upper classes. Embassy and international press reports cited mounting evidence of dissatisfaction among the lower classes, which were hurt by higher prices, scarcities of basic goods, and rising unemployment.<sup>4</sup> Internal opposition to the regime remained weak and poorly organized, however, and the Sandinistas retained their mass base of support. By portraying the United States as the main cause of Nicaragua's problems, the regime rallied domestic support, suppressed the opposition, and explained away economic shortfalls to most Nicaraguans. Moreover, despite the economic decline, the living standards of the lower classes and social services available to the poor remained above prerevolutionary levels. At the same time, the Sandinistas' use of neighborhood defense committees to distribute rationed goods increased their control of the population.

#### **The Next Few Years**

Although world agricultural commodity prices and demand, the level of Central American Common Market (CACM) trade, and the extent of insurgent activity will remain important, we believe that economic performance in 1983-84 will turn primarily on Managua's policies toward the private sector and the political opposition, as well as on the international financial response that such policies engender. The government's treatment of the private sector will shape business attitudes and influence the availability of foreign funds, factors that will have the most impact on investment and production in the key agricultural sector.

<sup>4</sup> We estimate joblessness substantially exceeded the 14-percent rate officially claimed in 1981.

**Confidential**

25X1

Confidential

---

**Burgeoning Foreign Debt**

*When the Sandinistas took power, they inherited \$1.6 billion in outstanding medium- and long-term public and publicly guaranteed external debt. Through a series of negotiations with overseas commercial banks during the period 1980-82, Managua rescheduled \$1 billion of these obligations, a sum that excluded only multilateral debt and bilateral US debt:*

- *In December 1980 Nicaragua reached agreement with 110 foreign commercial banks to reschedule \$900 million in central government debts. Under the agreement, principal payments would not be required during a five-year grace period. During that time, however, interest would be charged every six months at the rate of LIBOR plus three-fourths of a percentage point. Nicaragua would be allowed to capitalize any interest due above an annual rate of 7 percent.*
- *In December 1981 Managua rescheduled \$60 million in debts of the nationalized financial sector. Terms were the same as above.*
- *In March 1982 the Sandinistas signed an agreement with a consortium of 35 banks to reschedule \$70 million in obligations of private firms and nationalized industries. Conditions were similar to the earlier reschedulings.*

*Because Managua relied on foreign lending to finance economic growth, the external debt grew by roughly \$1.3 billion during 1980-82 and reached \$2.9 billion by the end of 1982. If the economy achieves 3-percent real growth annually during 1983-84, we calculate outstanding medium- and long-term public and guaranteed private debt would reach \$4.2-4.4 billion by the end of 1984. Even before amortization obligations resume in 1985, the debt service ratio could approach 60 percent unless agricultural output and world prices for farm commodities improve dramatically.*

---

Recognizing that these factors would drive the near-term outlook over the next few years, we analyzed their impact under three different scenarios. We assumed that foreign economic support would not increase much beyond current levels:

- *Case I:* The Sandinistas continue to harass the private sector but stop short of full-scale nationalization of business.
- *Case II:* The regime confiscates the remaining private sector.
- *Case III:* The Sandinistas are replaced by a government more sympathetic to the business community without appreciable damage to the country's economic base.<sup>5</sup>

Regardless of which scenario we examined, it was clear that a change in government policy alone would not be enough to improve depressed Nicaraguan living standards any time soon. At best, real per capita incomes will stagnate while the foreign financial gap widens. The same limitations on increasing the pace of economic growth stand out in each case:

- Past neglect of coffee trees and cottonfields will take several planting seasons to correct.
- Continued violence within Central America will tighten the supply of migratory labor and disrupt harvests.
- Export earnings available to fund critical new imports will be reduced because the Sandinistas already have mortgaged part of the 1983 crop to meet earlier debt service obligations.
- Even if global economic recovery is faster than generally expected, the spectacular rise in commodity prices and demand needed to remedy Managua's foreign exchange bind is unlikely to occur.
- The regional economy is likely to remain depressed and preclude a resurgence in CACM trade.

<sup>5</sup> For a fuller description of the sources and methodologies used in developing these cases, as well as a discussion of our data sources for 1981-82, see appendix C.

Confidential

25X1

25X1

**Confidential****Case I: Continued Sandinista Pressure on Business.**

We judge this scenario as the most likely to occur. Although the Sandinistas remain committed to Marxist-Leninist goals, we believe that at the insistence of Western lenders they will not soon nationalize the remaining private sector.

some key factions within the leadership recognize that managerial and technical skills in the private sector could not readily be replaced.<sup>6</sup> This basic conflict, which could be aggravated by any increased insurgent activity, will keep tension high between the business community and the government. The relationship will be subject to periodic fluctuations that will keep business in a state of uncertainty.

Under these circumstances, we judge that the private sector will undertake scant investment, and sustained economic recovery will evade the Sandinistas for at least the next two years. In this case, economic upturn would occur only if there is a large infusion of new foreign aid. Although modest recovery in agricultural output is likely provided weather conditions return to normal, shortages of critical imported fertilizers and pesticides will slow recovery of cotton and labor shortages will limit coffee and cotton harvests. We believe the shift toward basic grain production will continue, as farmers avoid the large investment associated with export crops. Depending on whether world agricultural commodity prices remain depressed or reach traditionally moderate levels, we project that yearly export earnings will reach \$420-500 million in 1983 and 1984.

At these export levels, we calculate that the widening foreign financial gap would be in the \$600-680 million range in 1983 and the \$735-815 million range in 1984 if Managua is merely to support the 3-percent annual rise in real output needed to protect per capita incomes and to honor foreign debt service obligations. To hold per capita incomes steady, Nicaragua would need imports worth about \$770 million in 1983 and \$855 million in 1984. Alternatively, for the economy just to stabilize in 1983 and then to achieve 3-percent expansion in 1984, foreign financing needs would still measure a hefty \$560-640 million in 1983 and \$700-780 million next year. Import volume and real GDP

would decline if overseas purchases fall below roughly \$730 million in 1983 and \$820 million in 1984. As a further drain on hard currency, Managua will be required to pay more than \$300 million annually to service the growing foreign debt, even with current soft terms. As it did in 1982, the regime probably will threaten repeatedly to stop paying interest on the more than \$1 billion debt owed to foreign commercial banks, but we believe their rhetoric is largely bluster.

Although we cannot discount the Sandinistas' proven ability to search successfully for foreign aid, we believe that they probably cannot secure enough new foreign lending to avert a further decline in economic activity. Mexico and other bilateral suppliers have their own financial problems that will continue to limit financing. International commercial banks probably will have scant reason to reverse past policies of offering only token loans. Recourse to the IMF is always possible, but we have no conclusive evidence that Managua would reconsider its unwillingness to approach the Fund. Soviet Bloc countries will be unlikely to supply large amounts of hard currency aid given their own hard currency shortages.

Consequently, the foreign exchange crisis will deepen, and the Central Bank will face increasing pressure to devalue the cordoba. Unless the regime sharply raises prices of basic goods, shortages will intensify, and rationing—already applied to gasoline, sugar, flour, salt, rice, beans, milk, and chicken—will spread to a broader range of goods. Unemployment will worsen, particularly in urban areas, as industrial production sags.

**Case II: Confiscation of the Private Sector.** Although we judge it unlikely that the Sandinistas will nationalize much of the remaining private sector in the next few years, such action would be possible if insurgent activity increases rapidly or if business investment does not grow and economic activity continues to decline sharply. The regime might feel that the security benefits of greater control over production would outweigh the economic costs of further nationalizations. Alternatively, Managua might gamble that many foreign lenders would tolerate a government takeover of most of the rest of the economy or that the Soviets would come up with large amounts of aid.

<sup>6</sup> For details on the views of key leaders, see appendix B.

**Confidential**

Confidential

If the Sandinistas choose this course, foreign borrowing requirements to sustain anything close to current living standards would skyrocket beyond those projected above. We believe that, as in Mozambique and Angola in the mid-1970s, the government would be unable to fill the void left by departing managers, technicians, and other businessmen. Even if these skilled workers remained in Nicaragua, their productivity would suffer from lack of adequate incentives. Other market distortions characteristic of centrally run economies would depress output and boost foreign aid needs, although Managua might—in the absence of additional foreign funding—simply force the burden of adjustment on consumers in the name of national defense, as happened in the Soviet Union in the 1920s, Cuba in the 1960s, and North Korea and Vietnam in the 1970s.

The reaction of foreign sovereign lenders and the Nicaraguan population to full-scale nationalization is difficult to project and, in the case of Western donors, would depend in part on the manner in which the confiscations were carried out. If Managua acted without violence, appeared to represent the will of the majority, and provided or promised some compensation to property owners (such as the long-term bonds used in earlier land reform confiscations), we believe international criticism could be muted. Although Moscow might add to existing supplier credits, we believe the Soviets—facing their own hard currency constraints—would avoid a large-scale bailout of the Nicaraguan economy.

In Case II, we believe the risk that Managua would cease payment on at least part of its foreign debt would be higher. In our view, the regime would continue to honor debt obligations only to the extent that they believed such payment would lead eventually to new lending. With chances for new loans from commercial banks virtually nil following a complete nationalization, Managua probably would stop servicing the portion of its debt owed to that source. Moreover, the government might well ignore claims by foreign businessmen to the now-mortgaged export crop and other assets.

**Case III: Change of Government.** If—without major violence and economic losses—the current government were replaced by leaders sympathetic to the private sector, we believe—based on a variety of evidence, including experience in other LDCs—that several years of stability would be essential before economic recovery could begin in earnest. During that time, foreign aid needs would still probably match those projected under our first scenario. Even with a new government that had wide private-sector support, a prolonged period of peace would be required before the foreign and domestic business confidence that is pivotal to economic recovery would return. Moreover, as in Jamaica since the early 1980s, the best of intentions could be overpowered by soft commodity markets and high interest rates that would discourage foreign capital investment.

Even global economic recovery would not quickly repair the damaged Nicaraguan economy. As occurred in varying degrees in Peru and Chile, legal disputes over property ownership and the difficulties of returning assets to the private sector would affect all sectors of the economy and would take time to resolve. Until the property titles were sorted out, skilled Nicaraguan expatriates would be slow to return and foreign private investment would not pick up. In the important agricultural sector, substantial investment would be needed to shore up export crop production and reverse the Sandinistas' shift toward basic grains. Because recovery of world agricultural commodity prices generally lags behind global economic improvement, the market would not quickly provide incentives for increased investment. Industry, the alternative engine of growth, would be hindered by the poor condition of capital stock. Even if foreign exchange were available to repair or replace cannibalized equipment, overseas suppliers might face bottlenecks as global economic recovery boosted demand for machinery.

Confidential



**Confidential****1985: A Pivotal Year**

If the Sandinistas stick to current policies and fail to secure massive amounts of new aid or much softer terms on debt repayment, unmanageable foreign debt service obligations at mid-decade could plunge the economy into a prolonged tailspin. Based on our projections of borrowing requirements in 1983-84, we calculate that total publicly guaranteed external debt could reach roughly \$4 billion in 1985. Principal payments on more than \$1 billion in rescheduled foreign obligations will begin to come due then, and the ensuing debt service burden could force Managua to stop debt payments temporarily and tempt the Sandinistas to repudiate the debt altogether.

The risk also will increase that the government will move closer toward its Marxist-Leninist goals by confiscating most remaining private assets. We judge that the Sandinistas will carry out their plan to hold national elections in 1985 and that they will win, whether honestly or not. This victory could strengthen the government's legitimacy and provide some appearance of political pluralism, both key concerns of international lenders. As a result, we believe that by 1985 the risk that foreign bilateral lenders would halt assistance in reaction to additional confiscations probably would be reduced.

**Implications for the United States**

Recent structural changes in the Nicaraguan economy have worrisome implications for US policy toward Nicaragua and Central America as a whole. Specifically, certain shifts characteristic of the Marxist-Leninist approach to economic development are taking place in Nicaragua that would be difficult to reverse:

- The focus of agricultural production is shifting from export commodities to basic crops, affecting profitability, the labor mix, and income distribution.
- The government is directing a growing share of investment, using forced savings of the middle class obtained through higher taxes and nationalizations.

- Through an increasing assortment of regulations as well as control of credit and foreign exchange, Managua is wresting economic decision making functions from the private sector.
- The regime is seeking closer ties with Communist countries. According to the Cuban press, Nicaragua soon will press for official observer status in the Soviet Bloc's Council for Mutual Economic Assistance (CEMA).

As a result of these changes, the potential costs of restoring free enterprise in Nicaragua are increasing daily. Moreover, regional Central American economic recovery will be delayed and foreign aid needs raised to the extent that Nicaragua—traditionally an active CACM trading partner—displays poor economic performance.

Under the present government, we expect anti-US rhetoric to grow and the economy to continue to shift toward Communist markets. In a growing search for foreign financial aid, Nicaragua is likely to increase anti-US rhetoric because the regime's probable inability to secure enough new hard currency lending to avert economic decline would cause the Sandinistas to step up propaganda blaming the United States for Nicaragua's economic problems. Lacking fresh infusions of credit, Managua's imports from the West would fall, and the production process and capital stock—formerly geared to Western machinery and materials—would begin to adapt toward inputs more readily available from Communist suppliers. To manipulate popular attitudes, the Sandinistas would heat up their publicity campaign that praises Soviet Bloc aid at the same time that they vilify the United States.



25X1

**Confidential**

Confidential

## Appendix A

### Restructuring and Recovery, 1980-81

Investor caution prevented strong private-sector performance in 1980, and business activity remained depressed in 1981 primarily because of the regime's harassment of the private sector. Consequently, private fixed investment averaged less than 5 percent of GDP during 1980-81, compared with more than 17 percent in 1977, according to World Bank statistics. Even large increases in official capital outlays were not enough to raise investment to traditional levels; the fixed investment-GDP ratio, which had reached 24 percent in 1977, slid to an average of 16 percent in 1980-81. More important, investment allocated to traditional growth-generating sectors shrank; the share of total public and private investment in goods-producing enterprises fell from about 9 percent of the total before the revolution to 5 percent in 1980-81 largely because public investment was concentrated in social projects.

The withering of the private sector yielded profound changes in the structure of the economy. The government's share of output mushroomed to 41 percent in 1981, from about 15 percent as recently as 1977. Government participation spread throughout the economy's productive sectors as a result of the Sandinistas' confiscation of the properties of former President Anastasio Somoza and his associates and continuing arbitrary nationalizations. Although public ownership of farms and factories was virtually nonexistent before the revolution, by 1981 Managua directly controlled 22 percent of agricultural production and 30 percent of industrial output. Government-provided services soared to 40 percent of the total, nearly double the prerevolution share.

Despite such government policies as preferential access to credit and foreign exchange that were designed to encourage recovery in the key agricultural sector, output remained well below prerevolutionary levels. Following a dismal performance in 1980, production rose 14 percent in 1981 but still remained 10 percent short of the peak 1978 level. Moreover, because the

crisis in business confidence prevented substantial improvement in investment-intensive export crops, production shifted toward basic crops—beans, corn, and rice—that generally require smaller investments and fewer imported inputs. Soft world commodity prices, shortages of critical imported fertilizers and pesticides, and mismanagement of state-run enterprises (for example, lack of proper care and maintenance of coffee trees) further disrupted production of important export crops including coffee, cotton, and sugar.

While exports floundered, the production of basic crops rose to exceed prerevolutionary levels by the end of 1981. This development was in line with the Sandinista goal of self-sufficiency in domestic food production, an aim that we believe stemmed partly from a desire to insulate Nicaragua from growing external threats and one that is—for similar general reasons—common to Marxist-Leninist economic systems. Despite success with basic grain production, however, domestic food supplies remained tight because reduced meat output, a growing population, and declining availability of imported foodstuffs increased demand for basic grains.

Like agriculture, industrial output—including manufacturing and construction—remained stalled below prerevolutionary levels. We calculate that, although real industrial production recovered 24 percent during the two years following the Sandinista takeover, 1981 output was still some 27 percent short of 1977 production. Much of the growth stemmed from public-sector construction directed toward repairing war damage. Even though the revolutionary violence had sharply reduced capital stock, industrial capacity utilization dropped to about 50 percent in 1981, from 70 percent in 1978. The large chemical industry, and others similarly dependent on sales to members of the depressed Central American Common Market (CACM), showed little improvement. Food processing, soap, pharmaceutical, and other industries catering to the domestic market did relatively well, however, because the import squeeze boosted demand for local goods.

Confidential

**Confidential**

With the agricultural and industrial sectors languishing, central government spending boomed; budget outlays climbed to 33 percent of GDP in 1981, from 10 percent in 1977. In keeping with the Sandinistas' revolutionary ideology, expenditures for social services soaked up the bulk of the budget. Real outlays for health, education, and welfare in 1981 exceeded prerevolutionary levels by 135 percent and claimed 27 percent of public spending.

Scrambling to cover burgeoning expenditures, Managua boosted taxes sharply. Revenues equaled 21 percent of GDP in 1981, compared with 12 percent in 1977, according to published World Bank statistics. Businesses and the middle class bore the brunt of the burden. Business taxes climbed from the low rates prevailing under Somoza to a flat 40-percent levy on profits. A near doubling of taxes on real property hit the middle class hardest. These new taxes, which effectively constituted forced savings, became Nicaragua's primary source of new investment, another strategy characteristic of Communist economic programs.

Even with these measures, tax revenues covered less than 70 percent of public expenditures, and the 1981 fiscal deficit approached \$300 million or 12 percent of GDP. Because heavy foreign borrowing provided only partial relief, Managua resorted to stepped up internal borrowing that strained the availability of domestic credit for the private sector. Although the government accounted for 40 percent of GDP,<sup>7</sup> it consumed almost two-thirds of all domestic credit and displayed political favoritism when allocating the remainder to various elements of the private sector. During 1980-81, as the government primed the money pump to alleviate the credit squeeze, the money supply virtually doubled and consumer prices rose a total of 66 percent.

<sup>7</sup> The government budget, at 33 percent of GDP in 1981, did not include outlays for semiautonomous agricultural agencies.

### **Foreign Payments**

Nicaragua's foreign financial gap widened enormously in 1981 as nominal annual export earnings remained more than 20 percent below prerevolutionary levels while imports grew steadily. Exports in 1981 barely exceeded weak 1980 levels as world agricultural prices dipped. Among key export crops, nominal coffee prices fell by about 25 percent in 1981 from their 1979 average, and always-volatile sugar prices began a steep slide after reaching a five-year peak in 1980. The manufacturing sector could not compensate for weak agricultural earnings because the important regional market for Nicaraguan goods had atrophied. Sales to CACM in 1981 represented only 14 percent of Nicaragua's total exports, down from 21 percent in 1977.

Buoyed by foreign aid from Mexico and elsewhere, nominal imports in 1981 exceeded prerevolutionary expenditures by 21 percent, but volume did not regain prewar levels. After tumbling by roughly 70 percent during the revolution, overseas purchases more than doubled in 1980 when Managua rushed to rebuild crumbling facilities and replenish depleted inventories. In 1981, however, the deepening foreign exchange shortage forced a 5-percent cut in imports as the regime tightened currency and trade controls in order to allocate imports to priority sectors. Imports of raw materials and intermediate goods plunged by about 20 percent and of consumer goods by about 15 percent. Purchases of foreign fuels and capital goods rose, but the private sector correctly charged that these items flowed disproportionately toward state-owned enterprises. The government periodically shortened the list of items for which import licenses would be issued, and businessmen complained that they could not get permits. Potential importers also were

**Confidential**

**Confidential**

hit with a de facto devaluation when the Central Bank stopped providing foreign exchange at the official rate of 10 cordobas per US dollar. Instead, private-sector importers were forced to buy foreign currency on the parallel rate market, where the exchange rate hovered around 24 cordobas per US dollar.

Even with import retrenchment and successful debt rescheduling, the foreign financial gap reached \$582 million in 1981, compared with \$220 million in 1977. Managua relied entirely on foreign aid to plug the gap and to improve slightly its net foreign exchange reserve position (gross reserves minus short-term obligations), which remained more than \$300 million in deficit at the end of 1981. Mexico, international financial institutions, and Libya supplied the bulk of this key support, which soared to about \$600 million—double the 1980 level. Mexico alone provided about \$250 million, including 100-percent financing of all the oil it sold to Nicaragua, loan guarantees, direct aid, and supplier credits for Mexican goods. Communist countries sent virtually no hard currency aid and limited their support to supplier credits for generally poor-quality equipment and long-term technical studies. In addition, Cuba sent several thousand teachers, doctors, and technicians. Although Soviet Bloc assistance did little to ease Nicaragua's tightening financial bind, Managua widely publicized this aid in an attempt to erode popular distrust of Communist states.



25X1

**Confidential**

Confidential

## Appendix B

## Key Economic Players

**The National Directorate**

All available intelligence indicates that the ruling National Directorate of the Sandinista National Liberation Front (FSLN) makes all major decisions regarding economic policy. According to US Embassy officials, the Directorate's nine members, the *comandantes*, expect the private sector to be dedicated exclusively to production and commercial activity without taking part in economic decision making. Moreover, the US Ambassador believes that Directorate members have a deep suspicion of and antagonism toward private enterprise. Although the *comandantes*

share these attitudes, we believe they have differing views of the private sector's role in Nicaragua's economic development over the long term.

**The Hardliners.** This group wants a gradual elimination of private enterprise. According to US officials in Managua, the hardliners believe that the FSLN must have total economic control. We judge that they emphasize security concerns and worry that their Marxist-Leninist beliefs would be compromised should they make concessions to the private sector.

25X1

US Embassy officials [redacted] who have had personal contact with Directorate members say that Bayardo Arce is [redacted] the only member of the Directorate who refuses to compromise his Communist convictions. [redacted]

[redacted] In his public statements he has blamed those problems on "imperialism" and the Somoza dictatorship. He has publicly stated that the continued survival of the private sector depends on the business community itself, implying that it must adhere to the rules set by the FSLN or face retaliation. Arce received a degree in journalism from the National Autonomous University of Nicaragua (UNAN) in the early 1970s. He is about 32.

Considered by US Embassy officials to be the Directorate's closest ally to Fidel Castro, Humberto Ortega may be a conduit for Cuban influence in Nicaragua. [redacted]

Public indications of Ortega's hardline attitude include two speeches he made in the summer and fall of 1981, equating Sandinism with Marxism-Leninism and threatening to hang members of the opposition from lampposts in the event of any armed intervention in Nicaragua. Ortega attended UNAN during the 1960s. He is about 41.

25X1

25X1

25X6

25X6

25X6

25X6

Confidential

**Confidential**

25X1

The US Embassy has observed that, as Minister of Interior with responsibility for internal security, Tomas Borge has shown more concern for the apparatus and theory of political control than for the detailed issues of economic reconstruction. In his public statements he has been the Directorate member most critical of the private sector, claiming that businessmen are guilty of "genocide and of the social and cultural backwardness of the people." He has stated that a mixed economy can exist in Nicaragua only in the context of the "revolution," where social criteria predominate over the individual's wishes. Borge studied law at UNAN during the 1950s. He is about 53.

**The Pragmatists.** We believe the pragmatists—like the hardliners—want the FSLN to maintain ultimate control in Nicaragua, but that they privately advocate moving toward a socialist state slowly, while preserving a significant role for the private sector. The pragmatists consider Nicaragua's deteriorating economy to threaten FSLN power and recognize the need to adjust their policies to suit economic realities. In our view, they have shown understanding of and willingness to listen to private-sector complaints.

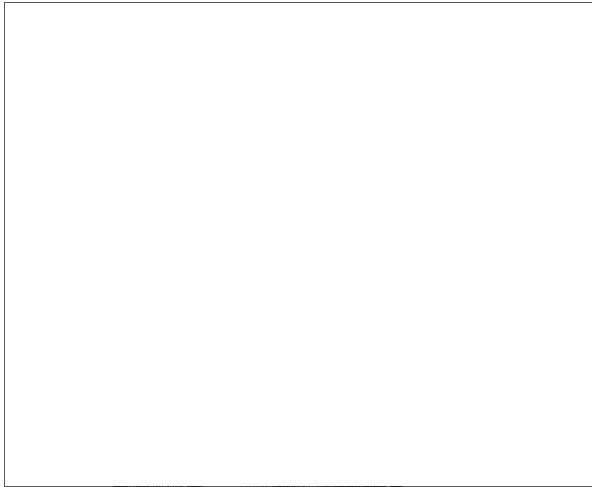
Although he is a committed Marxist-Leninist, we believe Jaime Wheelock

25X6

25X6

**Confidential**

Confidential



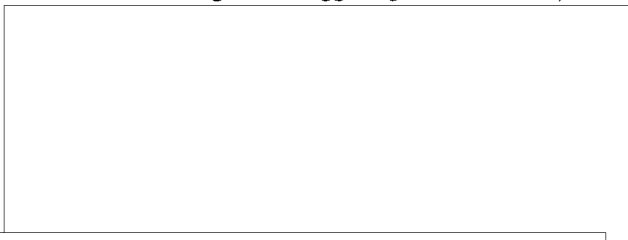
25X1

*The Pivotal Trio.* Depending on the issue, members of this group may support either the hardliners or the pragmatists.



25X1

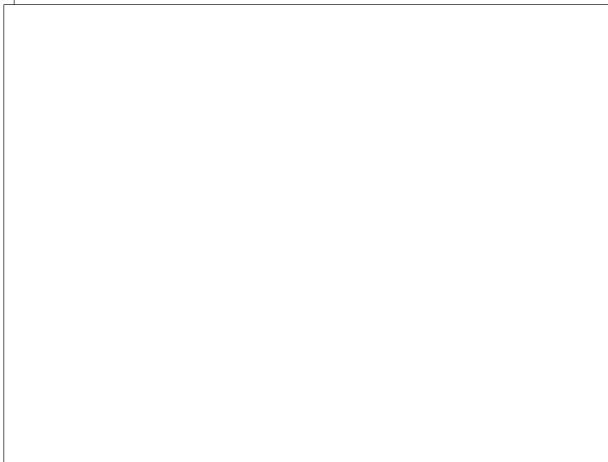
According to US Embassy officials, Luis Carrion has been described as a radical who has moderated his positions as a result of his friendship with Jaime Wheelock. (The two men lived in hiding together for six months during the struggle against Somoza.)



According to US Embassy officials, Daniel Ortega would be a key swing figure if a showdown developed between hardliners and pragmatists. His family ties link him to his hardline brother, Humberto.

25X6

25X6  
25X6



25X1

Carlos Nunez has a close friendship with Jaime Wheelock



25X6  
25X6

Confidential

**Page Denied**



**Confidential**

25X1

**The Private Sector**

The leaders of the private sector in Nicaragua generally opposed former President Somoza and supported the struggle against him during the late 1970s. When the ruling Sandinista National Liberation Front (FSLN) came to power in July 1979, these leaders looked for ways to contribute to the FSLN's stated goals of political pluralism and a mixed economy. Since then, the leaders of the Superior Council of Private Enterprise (COSEP) have become increasingly discouraged by the FSLN's deviation from its original goals, and they now are among the members of the opposition. In October 1981 four COSEP members were arrested for publishing a letter critical of government economic policy.<sup>8</sup>

US Embassy officers who know him report that Gilberto Cuadra exhibits a total distrust of the FSLN. In conversations with those officers after his release from prison (he was one of the four arrested leaders), he expressed concern that the private sector would be the first casualty of any regional military conflict. As head of the Confederation of Professional Associations (CONAPRO), Cuadra has been particularly critical of GRN/FSLN attempts to impose government controls on professional organizations.

25X1

According to US officials and businessmen who have met him, Enrique Dreyfus is intelligent and committed to a role for the business community in Nicaragua. In conversations with US officials he has repeatedly stressed the importance of US support of the private sector and the democratic opposition. Advocating a climate of "economic stability and psychological security" to reactivate the economy, Dreyfus has told US Embassy officials that the private sector has two objectives: to survive and to influence the policies and overall direction of the government. In order to achieve these objectives, he says that private-sector organizations must be strengthened by broadening their membership and by becoming indispensable suppliers of technical services. According to Dreyfus, who was one of the four imprisoned COSEP leaders, Nicaraguan businessmen must also lower their political profile in order to appear less confrontational to the FSLN. Dreyfus is about 57 years old.

US Embassy officials have described Ramiro Gurdian as a hardliner who opposes the FSLN. He places great importance on private producers in resolving Nicaragua's economic problems. Gurdian has told the press and US officials that the current political atmosphere discourages work and production. He also has expressed concern publicly about Nicaragua's negative international image; we believe that he is concerned because that image damages his country's ability to secure foreign aid from Western donors.

25X1

<sup>8</sup> For additional details on the mounting climate of hostility between the government and the private sector, see "The Government Versus the Private Sector," page 3.

**Confidential**

**Page Denied**

25X1

Confidential

## Appendix C

### Methodological Notes on Economic Forecasts

Economic estimates for 1981-82 and forecasts for 1983-85 were based on our analysis of official Nicaraguan information and other data from a variety of sources. Unlike the generally useful economic data provided by the Somoza government, Sandinista-supplied information has been inconsistent, sketchy, and outdated. It was thus necessary to supplement the data, particularly in certain key areas:

- **Foreign Aid.** Managua never has published detailed information. Our estimates relied on US Department of State reporting, data from lender countries, press reports [redacted]
- **Foreign Trade.** Published international financial information, particularly the UN trade series, was used to confirm and flesh out official trade data.
- **Foreign Debt.** Creditor bank reports were used to add perspective to government statements.
- **Agricultural Production.** Because private Nicaraguan farmers often refuted the official data, our estimates were based on US Departments of State and Agriculture reporting occasionally adjusted to reflect information provided by other sources.

Our projections for economic growth and foreign aid requirements for 1983-85 drew heavily on a World Bank study that links economic performance with import levels (*Nicaragua: The Challenge of Reconstruction*, 9 October 1981, Report No. 3524-N1). Foreign aid requirements were calculated as a residual:

$$CF = I - E + ST$$

Where CF equals net foreign capital, I equals import expenditures, E equals export earnings, and ST equals net services and transfers.

**Exports** were calculated as the product of projected volume and international commodity prices. For 1983, volume was projected to grow by 3 to 5 percent, primarily on the assumption of improved weather

conditions. Agricultural output in 1984 was projected to remain constant because we could identify no factor that would significantly boost production. High and low commodity prices were derived from world market trends since 1979, adjusted for commodity analysts' expectations based on the OECD business cycle and anticipated market developments. These prices were consistent with those extrapolated on the basis of Box/Jenkins statistical analysis. Our low case projects commodity prices continuing at the 1982 level, and our moderate indicator represents average annual prices during 1980-82.

**Net services and transfers** consisted primarily of known and anticipated direct grants and interest obligations on foreign debt. We projected that net expenditures for services and transfers would rise in 1983-85 because we saw no evidence that hard currency donations would reach the high levels prevailing in the recent past (\$98 million in 1980, \$57 million in 1981, and \$92 million in 1982). At the same time, we judged that the Sandinistas' past heavy foreign borrowing would cause interest obligations to increase.

**Real import aggregates**<sup>9</sup> were linked with economic growth using an incremental elasticity formula:

$$1.015I = 1.01GDP$$

We used this methodology as an adaptation of a World Bank technique. In the World Bank's best case projection for 1982-84, each 1-percentage-point change in real gross domestic product is associated with a 1.1-percentage-point change in real imports.

We modified this ratio because it was formulated by the Bank before the most recent data indicating Nicaragua's severe economic difficulties became available. We based our incremental elasticity projections on the 1971-77 average because the war and subsequent upheaval caused wild fluctuations in later years that makes the data base undependable. In the process we weighed the effects of developments that would tend to reduce this ratio (the trend toward subsistence farming and the growing government sector) against changes that probably would raise it

<sup>9</sup> Lack of detailed data prevented the disaggregation of imports by commodity or sector.

Confidential

**Confidential**

**Table 4**  
**Projected Foreign Financing Gap, by Scenario**

Million US \$

	1983				1984			
	0% GDP growth		3% GDP growth		3% GDP growth (following 0% growth in 1983)		3% GDP growth (following 3% growth in 1983)	
	Low Prices <sup>a</sup>	Moderate Prices <sup>a</sup>	Low Prices <sup>a</sup>	Moderate Prices <sup>a</sup>	Low Prices <sup>a</sup>	Moderate Prices <sup>a</sup>	Low Prices <sup>a</sup>	Moderate Prices <sup>a</sup>
Current account	-550	-470	-590	-510	-680	-600	-715	-635
Trade balance	-310	-230	-350	-270	-400	-320	-435	-355
Exports f.o.b.	420	500	420	500	420	500	420	500
Imports f.o.b.	730	730	770	770	820	820	855	855
Net services and transfers	-240	-240	-240	-240	-280	-280	-280	-280
Amortization	90	90	90	90	100	100	100	100
<b>Financial gap</b>	<b>-640</b>	<b>-560</b>	<b>-680</b>	<b>-600</b>	<b>-780</b>	<b>-700</b>	<b>-815</b>	<b>-735</b>

<sup>a</sup> These are projected commodity prices.

(pressures from consumers and the badly deteriorated capital stock and inventories). The track of import elasticities <sup>10</sup> for the full period 1961-85 <sup>11</sup> is shown in the following tabulation:

	1961-70	1971-77	1978-82	1983-85
All goods and nonfactor services	1.2	1.5	NA	1.5

Real imports calculated by means of this ratio for economic growth of 0 percent and 3 percent were converted to current values based on Data Resources Incorporated (DRI) projections for US wholesale price deflators.<sup>12</sup> For 1983 DRI forecasts 5.6-percent inflation; for 1984, 6.1 percent is expected.

<sup>10</sup> The elasticities presented are ratios of rates of growth in imports to rates of growth in GDP, rather than the partial income elasticities (*ceteris paribus*) of the theory of demand.

<sup>11</sup> Data for the years 1978-82 are distorted and are not useful in this calculation.

<sup>12</sup> This indicator reflects Managua's historically high reliance on US markets, still the largest individual supplier of Nicaraguan imports.

Scheduled amortization, the remaining item needed for our financial gap analysis, was taken from the World Bank study because experience has shown us that theirs is the best data base on LDC debt.

Table 4 summarizes the full range of our financial gap analyses under various scenarios.

**Confidential**

**Confidential**

**Confidential**